

Message Text

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ACTION EUR-12

INFO OCT-01 ISO-00 AID-05 CIAE-00 COME-00 EB-08 FRB-01
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CEA-01 L-03 H-02 PA-02 PRS-01 AGRE-00 HUD-02
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FM AMEMBASSY OTTAWA

TO SECSTATE WASHDC 5925

INFO ALL CONGENS IN CANADA BY POUCH

UNCLAS SECTION 01 OF 02 OTTAWA 00168

DEPT. PASS CEA, TREAS, FRB

E.O. 11652:N/A

TAGS: ECON, EFIN, CA

SUBJECT: RECENT ECONOMIC AND FINANCIAL DEVELOPMENTS

1. SUMMARY. CONSENSUS OF PRIVATE FORECASTERS INDICATES THAT REAL GNP WILL RISE BETWEEN 3-4 PERCENT IN 1978, WHILE INFLATION WILL MODERATE. RECENTLY PUBLISHED INDICATORS OF ECONOMIC PERFORMANCE CONTINUED TO GIVE MIXED READINGS. AUTO TRADE DEFICIT WITH U.S. REPORTEDLY REACHED CDOLS 1.0 BILLION IN 11 MONTHS TO NOVEMBER, 1977. SHORT AND LONG TERM INTEREST RATES ROSE IN WEEK ENDING JANUARY 6 AND EXPECTATION NOW UNIVERSAL THAT INTEREST RATES WILL RISE DURING COURSE OF THIS YEAR. CANADIAN DOLLAR FLUCTUATED CONSIDERABLY AGAINST U.S. DOLLAR DURING WEEK, BUT ON AVERAGE REMAINED UNCHANGED FROM PREVIOUS WEEK. END SUMMARY.

2. DOMESTIC DEVELOPMENTS. CONSENSUS OF PRIVATE FORECASTS SURVEYED BY TORONTO GLOBE AND MAIL PUTS EXPECTED REAL GNP GROWTH IN 1978 AT 3-4 PERCENT WITH UNEMPLOYMENT RATE RISING TO 9 PERCENT FROM CURRENT LEVEL OF 8.5 PERCENT. CONSENSUS UNCLASSIFIED

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FORECAST ESTIMATES INFLATION RATE (CPI) OF 7.6 PERCENT, RELATIVELY STRONG REAL CONSUMPTION GROWTH (4 PERCENT), NEAR STAGNATION OF PRIVATE INVESTMENT SPENDING AND CDOLS 5.5 BILLION CURRENT ACCOUNT DEFICIT. CONSENSUS FORECAST IS FAIRLY CLOSE TO EMBASSY'S REVISED PROJECTION OF 1978 OUTLOOK (SEE SEPTTEL).

3. RECENTLY PUBLISHED INDICATORS CONTINUE TO GIVE MIXED READING OF ECONOMIC PERFORMANCE. IMPERIAL BANK OF COMMERCE'S LEADING INDICATOR CONTINUED TO DECLINE IN OCTOBER. INDEX HAS SHOWN WEAK PERFORMANCE SINCE LAST APRIL.

4. CENTRAL MORTGAGE AND HOUSING CORPORATION REPORTED THAT HOUSING STARTS BOOMED IN DECEMBER TO ANNUAL RATE OF 296,400, THE HIGHEST LEVEL SINCE NOVEMBER, 1976. FOR 1977 AS A WHOLE, HOUSING STARTS AVERAGED 245,000 DOWN 12.2 PERCENT FROM 273,203 IN 1976. SHARP RISE IN HOUSING START PROBABLY LINKED TO FACT THAT PROVISION, UNDER WHICH DEPRECIATION ON NEW MULTI UNIT HOUSING COULD BE DEDUCTED FROM INCOME FROM ALL SOURCES, WAS DUE TO EXPIRE ON 7 JANUARY, 1978. ALTHOUGH PROVISION WAS EXTENDED FOR ADDITIONAL YEAR IN OCTOBER GOC MINI-BUDGET, BUILDING PLANS HAD ALREADY BEEN SET SO AS TO TAKE ADVANTAGE OF TAX SAVINGS BEFORE YEAR END. FACT THAT MULTI UNIT STARTS ACCOUNTED FOR MUCH OF INCREASE SUPPORTS THIS EXPLANATION.

5. UNCERTAINTY IN MORTGAGE MARKET HAS INCREASED WITH GOC PROPOSAL TO ELIMINATE CLOSED MORTGAGES (I.E. MORTGAGES WHICH CARRY PENALTIES FOR EARLY REPAYMENT). INDUSTRY HAS SPOKEN OUT STRONGLY AGAINST PROPOSAL AND HAS INDICATED THAT ELIMINATION OF CLOSED MORTGAGES WILL MEAN SHORTER MATURITIES AND HIGHER MORTGAGE INTEREST RATES.

6. PRICES. RETAIL COUNCIL OF CANADA HAS PUBLISHED FORECAST SHOWING THAT AVERAGE RISE IN FOOD PRICES IN 1978 OVER UNCLASSIFIED

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1977 COULD BE BETWEEN 8.6 PERCENT AND 10.6 PERCENT. UNCERTAINTY CONCERNING MEAT PRICES ACCOUNTED FOR MOST OF DIFFERENCE IN TWO FORECASTS. BOTH FORECASTS SEE REDUCTION IN RATE OF FOOD PRICE INCREASE DURING COURSE OF 1978.

7. INDEX OF INDUSTRY SELLING PRICES ROSE 0.5 PERCENT TO 177.1 BETWEEN OCTOBER AND NOVEMBER AND STOOD 8.3 PERCENT ABOVE LEVEL OF NOVEMBER, 1976. COMPONENTS CONTRIBUTING MOST TO OVERALL INCREASE WERE FOOD AND BEVERAGES, CHEMICAL AND CHEMICAL PRODUCTS AND PRIMARY METALS.

8. EXTERNAL DEVELOPMENTS. PRELIMINARY FIGURES RELEASED BY AUTOMOTIVE PARTS MANUFACTURERS ASSOCIATION (APMA) INDICATE THAT CUMULATIVE CANADIAN AUTO TRADE DEFICIT WITH U.S. IN 1977 REACHED CDOLS 1.0 BILLION IN NOVEMBER. CDOLS 2.5 BILLION DEFICIT IN PARTS TRADE REPRESENTS CDOLS 500 MILLION INCREASE OVER FIRST 11 MONTHS OF 1976. OVER SAME PERIOD, SURPLUS ON ASSEMBLED VEHICLES ESTIMATED TO HAVE RISEN CDOLS 400 MILLION TO CDOLS 1.7 BILLION. APMA PRESIDENT LAVELLE RECENTLY EMPHASIZED THAT AUTO PARTS INDUSTRY WOULD BENEFIT SIGNIFICANTLY FROM CANADIAN DOLLAR DEPRECIATION AND FROM EXPANSION OF DUTY REMISSION SCHEME (SEE SEPTTEL).

9. CAPITAL MARKETS. INTEREST RATE ON 90 DAY TREASURY BILLS WAS 7.14 PERCENT IN WEEK ENDING JANUARY 6, DOWN SLIGHTLY FROM 7.17 PREVIOUS WEEK. MONEY MARKET RATES INCREASED BY 5 - 10 BASIS POINTS. LONG TERM BOND RATES ROSE AS BOND PRICES FELL ABOUT SEVEN EIGHTHS POINT. ONTARIO HYDRO'S CDOLS 200 MILLION DOMESTIC MARKET DEBENTURE ISSUE SELLING AT DISCOUNT RAISING EFFECTIVE YIELD FROM 9.37 TO 9.58. PORTION OF ISSUE REMAINS UNSOLD AS BUYERS ARE APPARENTLY HOLDING OUT FOR HIGHER INTEREST RATES. PRICE OF PROVINCE OF ONTARIO DEBENTURES HAS ALSO BEEN CUT. PROVINCE OF SASKATCHEWAN HAS DELAYED ISSUANCE OF CDOLS

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75 MILLION BOND ISSUE DUE TO RISE IN INTEREST RATES.
10. GOC EXPECTED TO ANNOUNCE NEXT WEEK ITS FIRST MAJOR BOND ISSUE OF 1978. ISSUE COULD EXCEED CDOLS 1.0 BILLION WITH BANK OF CANADA TAKING CDOLS 400 - 450 MILLION. NEWS OF UPCOMING GOC ISSUE WAS IMPORTANT FACTOR DEPRESSING BOND PRICES.
11. WITH RECENT INCREASE IN U.S. DISCOUNT RATE AND PRIME RATE, EXPECTATION UNIVERSAL THAT CANADIAN INTEREST RATES WILL RISE DURING COURSE OF THIS YEAR. MOST OBSERVERS FEEL THAT GOC SHOULD (AND WILL) MAINTAIN POSITIVE SPREAD BETWEEN CANADIAN AND U.S. INTEREST RATES TO AVOID FURTHER DEPRECIATION OF CANADIAN DOLLAR. MOREOVER, FEDERAL GOVERNMENT EXPECTED TO BORROW IN RECORD AMOUNTS OVER NEXT 12 MONTHS.
12. FOREIGN BORROWING. PRICE OF BELL CANADA'S U.S.DOLS 200 MILLION DEBENTURE ISSUE IN NEW YORK WAS CUT, RAISING YIELD FROM 9 PERCENT TO 9.1 PERCENT.

13. EXCHANGE RATE. CANADIAN DOLLAR DROPPED WITH ANNOUNCE
MENT THAT U.S. WOULD INTERVENE MORE ACTIVELY IN SUPPORT
OF U.S. DOLLAR. LOST GROUND WAS QUICKLY RECOVERED AND
AVERAGE EXCHANGE RATE FOR WEEK ENDING JANUARY 6 WAS 91.35
CENTS, UNCHANGED FROM PREVIOUS WEEK. DUEMLING
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